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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996	)	CC Docket No. 96-128

PETITION OF APCC
FOR PARTIAL RECONSIDERATION AND CLARIFICATION

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SUMMARY

The American Public Communications Council ("APCC") petitions for partial reconsideration and clarification of certain limited aspects of the Commission's Report and Order. The Order as a whole reflects painstaking efforts to achieve a fair perspective and a well thought-out policy for restructuring this complex industry sector.

APCC supports the petition for reconsideration of New Jersey Payphone Association, requesting reconsideration or clarification of some of the Commission's non-discrimination and nonstructural safeguards rulings. In addition, APCC urges reconsideration or clarification in four areas. First, the Commission should require carriers that block calls from payphones to avoid paying compensation to notify the payphone service provider ("PSP") and provide an announcement that the carrier, not the PSP, has blocked the call. This is essential to avoid caller confusion and unwarranted economic injury to PSPs.

Second, the Commission should reconsider and rule that states may not require routing of 0- calls to the local exchange carrier ("LEC"). Any procedure for LEC handling of such calls results in unnecessary caller confusion and unlawful discrimination against independent PSPs. Since most states allow qualified operator service providers ("OSPs") other than the incumbent LEC to handle 0- calls, it is clear that emergency callers are well protected by such rules as well as the FCC's own rules, without a restrictive LEC routing rule.

Third, the Commission should amend its rule on public interest payphones to provide that payphones located within 200 yards of another payphone are not eligible for support.

Fourth, the Commission should reconsider its decision on valuation of the LECs' deregulated payphone operations. It is undisputed that LEC payphone operations have a market value far in excess of the net book value of the physical equipment. The Commission's decision adopting net book value rests on the application of accounting rules that are simply contrary to the clear Congressional intent. Further, the policy consequences of the rule result in a failure to credit ratepayers for the full value of payphone operations they have subsidized for years, and the creation of perverse incentives that effectively prevent business decisions by LECs to move their payphone operations to a separate affiliate, or sell them to third parties. In addition, the decision distorts perceptions of the profitability of LEC payphone divisions and encourages them to engage in predatory conduct. The Commission should reconsider and require "transfer, at an appropriate valuation, . . . to . . . unregulated books" in accordance with Congressional intent.

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To: The Commission

PETITION OF APCC
FOR PARTIAL RECONSIDERATION AND CLARIFICATION

The American Public Communications Council ("APCC") hereby petitions for partial reconsideration and clarification of the Commission's Report and Order in this proceeding, FCC 96-388, released September 20, 1996 ("Order"). Review of the Order as a whole makes abundantly clear that the Commission has devoted painstaking efforts to reach fair resolution of the issues. Much of the Order demonstrates a cogency of analysis that provides, at long last, an important and well thought-out policy for restructuring this complex and often poorly understood sector of the telecommunications industry.

It is in the context of APCC's strong support for the fundamental direction of the Order and most of its implementing provisions that APCC submits this petition for partial reconsideration on a number of specific but important issues. In addition, APCC supports the petition of the New Jersey Payphone Association ("NJPA") for partial reconsideration and clarification, in which NJPA requests rulings that require LECs to provide: (1) coin services with the ability to rate calls at a PSP's selected rates; (2) unbundled answer supervision; (3) nondiscriminatory call tracking; (4) nondiscriminatory commission payments; and (5) other non discriminatory services priced on a cost-allocated basis.

I. ANY CARRIER THAT BLOCKS CALLS ORIGINATING FROM PAYPHONES MUST BE REQUIRED TO NOTIFY THE OWNER OF THE PAYPHONE AND TO PROVIDE AN ANNOUNCEMENT EXPLAINING THAT THE CARRIER, NOT THE PAYPHONE PROVIDER, HAS BLOCKED THE CALL

In the per-call compensation regime established in Section I of the Order, when compensation for a call is not addressed in a contract between a carrier and a payphone service provider ("PSP"), each facilities-based carrier is required to pay the PSP a default rate, currently set at 35 cents per call,[1] for each completed non-coin call originating from the payphone, for which the facilities-based carrier is the primary facilities-based economic beneficiary. However, the Order states that carriers that do not want to pay 35 cents per call (and are unable to negotiate a different rate) may block calls originating from the payphone. Order, ¶¶ 49, 73.

To the extent that carriers exercise an option to block calls originating from payphones, there is potential for market disruption, consumer confusion, and resulting injury to PSPs. For example, if a carrier blocks calls from a payphone and does not take steps to

[1] In years subsequent to the first year of per-call compensation, the per-call amount will be adjusted to reflect the actual rate charged at the payphone for a local coin call.

inform either the payphone provider or consumers, callers attempting to place calls from the payphone will not know why they are unable to complete the calls. Such callers are likely to assume that the payphone is malfunctioning, or that the PSP has deliberately blocked the call. The result will be complaints to the PSP or location owner and unwarranted injury to the PSP's business.

To minimize such potential disruption and confusion, the Commission should require that any carrier that blocks calls from a payphone must inform the PSP at least 30 days in advance of blocking, so that the PSP can take appropriate steps to avoid confusion and disruption of its business. In addition, the Commission should require that, when a carrier blocks calls from a payphone, the carrier must provide an announcement to the caller that states: "[name of carrier] is refusing to accept this call from this phone. The payphone is not malfunctioning."

II. 0- ROUTING

The Commission's Order rules that state rules requiring the routing of intraLATA [2]calls to the incumbent LEC are inconsistent with the 1996 Act. Order, ¶ 261. However, the Order does not preempt state rules that require routing of 0- calls to the LEC, provided that

[2] The Commission should clarify that "intraLATA" in this context includes all intraLATA calls, including local calls. There is no evidence that Congress meant to exclude local calls from the scope of Section 276(b)(1)(E), and the policies of market competition and freedom of choice that support PSPs' right to select the intraLATA carrier presubscribed to their payphones are equally applicable to intraLATA local calls as to intraLATA toll calls.

"the state does not mandate that the LEC ultimately carry non-emergency intraLATA calls initiated by dialing '0' only." Id., ¶ 263.

In this latter respect, the Commission's ruling should be reconsidered, because it fails to ensure nondiscriminatory treatment of LEC and independent payphones and fails to fully implement the intraLATA carrier selection provision of Section 276. 47 U.S.C. § 276(b)(1)(E). Approximately 16 states require routing of 0- calls to the LEC.[3] The remaining states allow 0- calls to be routed to other operator service providers ("OSPs') that meet applicable standards for handling emergency calls. Thus, a substantial majority of states have not found it necessary to route 0- calls to the LEC in order to ensure appropriate handling of 0- emergency calls.

Mandatory routing of 0- calls to the LEC inevitably results in the LEC gaining an unwarranted advantage in terms of the ability to turn 0- calls into revenue producing calls. This advantage is very significant because APCC's statistics indicate that 0- calls represent roughly 5% of all non-coin calls, and more than 25% of the total number of 0- and 0+ calls dialed at payphones -- the calls that have the greatest revenue producing potential for a PSP. See APCC Comments, Att. 1.

While the LEC may not be "mandated" to carry a non-emergency 0- call, the Commission does not explain how it will be ensured that such calls are appropriately handled once they arrive at the LEC operator and are determined to be nonemergency calls. Any

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[3] Based on the information available to APCC, the following states require routing to the LEC: Alabama, Arkansas, Connecticut, Florida, Georgia, Indiana, Kansas, Kentucky, Maine, Mississippi, Nevada, North Carolina, Ohio, South Carolina, Vermont and Wisconsin.

procedure selected will inevitably result in both caller confusion and discrimination in favor of the LEC.[4]

For example, if the LEC operator is instructed to automatically hand off nonemergency calls to the OSP designated by the PSP, then callers will experience a far worse degree of service on 0- calls at independent payphones (if presubscribed to a non-LEC OSP) than at LEC payphones (which presumably will continue to be overwhelmingly presubscribed to the LEC on intraLATA calls). At the LEC payphone, the call will go to a LEC operator, and once determined to be nonemergency will continue to be handled at that same operator. At an independent payphone, by contrast, the call will initially go to the LEC operator, and after a conversation with that operator the caller will be transferred to a new carrier that must introduce its own operator to help the 0- caller complete the intended call. Thus, the independent PSP will be forced to subject callers to the confusion of call processing by two operators, while the LEC PSP can use only one.

Alternatively, if the solution is to ask the caller his or her preference, discrimination will still almost inevitably result. The calls will be handled by human operators employed by the LEC, who will have an inherent incentive to encourage the caller to express a preference for the LEC. Further, the need to affirmatively ask the caller about OSP preferences will lead to additional and avoidable caller confusion.

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[4] Moreover, mandatory routing to the LEC complicates the compensation system. When 0- calls are routed to non-prescribed carriers, the originating PSP is entitled to compensation, and APCC requests that the commission so clarify its rules. However, the tracking of such calls for compensation purposes is rendered more difficult by the intervention of the LEC operator.

There is no legitimate reason to conclude that LEC operators are the only operators that can appropriately handle 0- calls. As the Commission noted in the Order, OSPs are already subject to a Commission regulation requiring them "to ensure immediate connection of emergency calls to the proper service for the reported location of the mergency, if known, and, if not known, for the originating location of the call." Order, ¶ 260, n. 835, citing 47 CFR § 64.706. Since most states currently permit qualified OSPs other than the LEC to handle 0- calls, it can be safely assumed that a nonexclusive policy can be relied upon to effectively protect callers in emergencies. Such a policy also reduces caller confusion by reducing the need for involvement of multiple operators in 0- calls. The Commission should reconsider and rule that 0- calls can be routed to any OSP, subject to the requirements of Section 64.706 of the Commission's rules and to bhe ability of the states to establish nondiscriminatory standards for OSPs to qualify to handle emergency calls.

III. PUBLIC INTEREST PAYPHONES

APCC believes that the Commission's approach to implementing Section 276(b)(2) of the Act, 47 U.S.C. § 276(b)(2), is generally evenhanded, reasonable, and in most instances appropriately focused on the very narrow class of payphones that can truly be described as "public interest payphones." APCC urges a modification of the ruling to make clear that the "public interest payphone" category cannot include payphones located within 200 yards of another payphone unless there is some physical barriers to access. In such circumstances, the proximity of another payphone is ample proof that the location in question is not one where payphones cannot be profitably maintained.[5]

IV. THE COMMISSION'S RULING ON VALUATION OF LEC PAYPHONE ASSETS IS CONTRARY TO LAW AND POLICY

APCC requests reconsideration of the Commission's decision on valuation of the LECs' deregulated payphone operations. Order, ¶¶ 161-71. Section 276(b)(1)(B) requires the Commission to discontinue the access charge elements and all other payphone subsidies from basic exchange and exchange access revenues. The Conference Report expressly states that to implement this requirement:

> [t]he payphone operations will be transferred, at an appropriate valuation, from the regulated accounts associated with local exchange services, to the BOC's unregulated books.

Conference Report at 158. For the reasons stated below, the Commission improperly failed to adhere to this clear indication of Congressional intent when it chose to value the LECs' payphone operations at the net book value of the physical assets, rather than the actual economic value of the payphone business as a "going concern."

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[5] The Conference Report specifically noted that "the term [public payphone] doe not apply to a payphone located near other payphones. . . ." Jt. Statemenet of Managers, S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 159 (1996) ("Conference Report ").

A. The "Going Concern" Valuation Of LEC Payphone Operations Far Exceeds Their Net Book Value

The record evidence showed, and it is undisputed, that the actual economic value of those "payphone operations," which properly should include the value of intangibles such as payphone location contracts and goodwill, is likely to be far in excess of net book value, which is the valuation advocated by the BOCs Bell companies and adopted by the Commission. Thus, valuation at net book value would not come even close to ensuring that ratepayers are repaid for the actual economic value of RBOC payphone operations.[6]

In the payphone context, the value of payphone assets is enhanced by the payphone provider's selection of the locations where payphones are installed, as well as by the contracts between the LECs and location providers. See Reply Comments of the Georgia Public Communications Association ("GPCA') at 13-14.

These value enhancements are reflected in the prices that have been paid when payphone businesses are sold. In GPCA's Comments in this proceeding, GPCA provided a study by NuCom, an IPP provider, which reviewed per-pay phone prices paid in recent acquisitions of IPP providers. GPCA Comments at 17 and Attachment 1. The average per

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6 It is not just the payphone equipment that is being transferred. The equipment will remain at the existing locations pursuant to contracts and relationships established at ratepayers' expense. Unless the contracts are rescinded in order to give location providers a "fresh look," the location contracts are also being effectively reclassified or transferred, and the RBOCs' shareholders, not their ratepayers, will reap all the benefits of those contracts as well as associated goodwill. In addition to location contracts, the value of LEC payphone assets also is enhanced by the goodwill that has resulted from the investment of ratepayer money in maintaining payphones at a location. The RBOCs have admitted (RBOC Coalition Comments at 16) that ratepayers for other RBOC services have subsidized the RBOCs' payphone operations, which include commission payments and other services intended to enhance location provider satisfaction with RBOCs' payphones.

payphone price was approximately $3,200, which at a minimum can be used as a benchmark for beginning to review transfer valuation methods. Id. Likewise, in the Reply Comments of Communications Central Inc. ("CCI"), CCI showed that it allocated over 65% of payphone business acquisition purchase prices to intangibles such as location contracts. CCI Reply comments at 15-16 and Attachment B. These benchmarks demonstrate that the economic value of payphone assets is enhanced by intangibles such as goodwill and location contracts, and that net book value would be a totally inadequate measure of economic value.

Finally, in GPCA's Reply Comments, GPCA showed that U S West offered to pay $1,600 per site to acquire a bankrupt IPP provider's payphone business, and U S West sought to acquire only the IPP provider's location contracts and good will -- U S West did not even want any of the physical equipment. GPCA's Reply Comments at 14 and Attachment 3. This example is overwhelming proof that net book value does not capture the value of pay telephone assets transferred out of regulation.

B. The Commission's Refusal To Require A Determination Of Actual Economic Value Is Contrary To Law

The Commission's Order itself acknowledges that the value of the intangibles discussed above is properly included in the fair market value of the Bell Companies' payphone assets and would be credited to ratepayers if the payphones were transferred to a separate affiliate. Order, ¶ 164. However, the Commission decided that ratepayers are not entitled to that credit when a LEC's deregulated payphone operations are retained in the same corporate entity with regulated services. The Commission concluded that its existing accounting rules require that fair market value not be considered when assets are retained in the same corporate entity. In those circumstances, the payphone assets are merely being "reallocated," and the Commission found that its existing accounting rules require that reallocated assets be booked at net book value, regardless of their actual economic value. Rather than alter its accounting rules to carry out the Congressional intent, the Commission concluded that the Conference Report could not have meant what it said when it stated that the RBOC payphone operations would be "transferred, at an appropriate valuation, . . . to the BOC's unregulated books."

This portion of the Commission's Order is contrary to both law and policy and must be reconsidered. The Commission is not authorized to adhere to its existing rules regardless of the statutory command. Rather, the Commission is required to adhere to the unambiguous Congressional intent. Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837, 842 (1984).

1. The Committee Report Unambiguously Expresses Congressional Intent that Payphone Operations be Transferred, at an Appropriate Valuation, to Unregulated Books

The committee report made clear that the payphone operations were to be "transferred, at an appropriate valuation," from the Bell companies' regulated accounts to their "unregulated books." This statement plainly directs the Commission to do several things, none of which the Commission has done. First, Congress intended that the assets be "transferred . . . to . . . unregulated books," not reallocated. The Commission has expressly denied that there is any transfer, and the accounting treatment it has required leaves the Bell Companies' operations on the regulated books, not the unregulated books. Second, Congress intended that there be "an appropriate valuation," not a blind reshuffling of numbers in books of accounts. By treating the change as a mere reallocation of assets, the Commission has precluded any "appropriate valuation" of the transferred payphone operations. Third, Congress intended that the entire Bell company "payphone operations" are to be valued and transferred, not just the physical equipment. The treatment dictated by the Commission assigns no value to anything other than the physical assets.

2. The Committee Report Language is Fully Consistent with the Statutory Language

The Commission seems to be reluctant to do anything that is inconsistent with its existing accounting rules. However, this is a rulemaking. It is axiomatic that in a rulemaking, the Commission can change existing rules to the extent necessary to carry out its purposes. Indeed, the Commission acknowledges that Section 276 gives it the authority to change its accounting rules. Order, ¶ 162. Further, this is a rulemaking specifically directed by Congress to carry out a restructuring of the payphone industry. There would be no need for such a rulemaking if Congress had simply desired the Commission to apply existing rules.

The Commission reasons, however, that, to the extent that carrying out the committee report's statement of intent would require a change in the Commission's accounting rules, the Commission may disregard that statement because it is inconsistent with the language of the statute.

The Commission makes two arguments to support this claim. First, the Commission notes that Congress chose not to require that payphone operations be transferred to a separate subsidiary. The Commission reasons that "if Congress intended that there be a "transfer", we believe that Congress would have required . . . separate affiliates . . . ." Order,

¶ 170. This argument is simply fallacious. It is entirely consistent for Congress to intend that payphone operations remain in the same corporate entity with regulated exchange operations, while requiring that they be transferred to separate books of account. The Commission itself mandated such treatment when it deregulated customer premises equipment ("CPE") of non-Bell LECs. Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services (Second computer Inquiry), Fifth Report and Order, FCC 84-547, 49 Fed. Reg. 46378 (Nov. 26, 1984) ("CPE Detariffing, 5th Report and Order"). Indeed, elsewhere in the Order the Commission recognizes that the appropriate implementation of Section 276 is to reclassify payphones as CPE; it is entirely logical that Congress intended to require the transfer of payphone operations to unregulated books.

The Commission's second argument is that transfer to unregulated books would be inconsistent with the statutory requirement that it adopt nonstructural safeguards that are, at a minimum, equal to those adopted in Computer III. The Commission reasons that since its current cost accounting rules, based on cost allocation, are part of the "nonstructural safeguards" of Computer III, exclusion of those cost allocation rules would be contrary to the Congressional intent that they be included. Id. This argument too, is fallacious. For example, when AT&T and the Bell companies were subject to structural separation requirements, with separate books, they nevertheless allocated the cost of services shared between the nonregulated subsidiaries and the regulated telephone service company.[7] Conversely, as

[7] See e.g., General Departments Order, 90 FCC 2d 184 (1981); Shared Services Order, 92 FCC 2d 676 (1982), recon. denied, FCC 83-355 (released July 29, 1983); American Information Technologies Inc., et al., Capitalization Plans for the Furnishing of Customer Premises Equipment and Enhanced Services, FCC 85-28, File Nos. 84-(25-31), released Feb. 4, 1985, aff'd NATA v. FCC, 772 F.2d 1282 (7th Cir. 1985).

mentioned above, when the Commission deregulated independent LECs' CPE without subjecting them to separate subsidiary requirements, it nonetheless required the LECs to transfer the CPE to nonregulated books. Under the rules established by that order, cost allocations could be and were performed to allocate joint and common costs between regulated service and nonregulated CPE activities. CPE Detariffing, 5th Report and Order. Even under the Commission's current rules, the rules expressly recognize that in some circumstances, carriers that are not subject to structural safeguards and that have not established corporate affiliates, nonetheless may be subject to "transfer/valuation" rather than "reallocation" treatment for certain intracorporate transactions. 47 CFR § 32.23(b).

Moreover, the Commission's current rules authorize and require the use of market value-related concepts to determine the proper accounting for some activities of entities subject to cost allocation. For example, a LEC must impute basic services utilized by its own nonregulated enhanced services activities at the tariffed rate for those services. 47 CFR § 64.901(b)(1).

The Commission does not need to do away with its cost allocation rules in order to carry out Congressional intent that "payphone operations. . . be transferred, at an appropriate valuation, . . . [to] unregulated books." There is no necessary inconsistency between the use of separate books and a market valuation of deregulated payphone assets, on one hand, and the application of cost allocation rules to account for investment and expenses that are shared between regulated activities and nonregulated payphone operations.

The references in the statute and committee report to Computer III as the minimum level of "nonstructural safeguards" do not authorize the Commission to disregard clear indications of Congressional intent as to the manner in which reclassification of existing payphone assets should be carried out. Computer III involved the application of a wide variety of "nonstructural safeguards," none of which are intrinsically tied to the use of a particular system of cost accounting.[8]

Furthermore, the statutory requirement to adopt nonstructural safeguards is in a separate paragraph of Section 276 from the requirement to terminate existing access charge elements and subsidies. The sentence of the committee report that states that existing payphone operations are to be "transferred to unregulated books" is clearly intended to refer to the Section 276(b)(1)(B) requirement to discontinue existing access charge elements and subsidies. The subsequent sentence of the Conference Report, which discusses nonstructural safeguards and the Computer III minimum, obviously references Section 276(b)(1)(C), which discusses those same nonstructural safeguards and Computer III minimum. Thus, the two sentences of the Conference Report refer to separate provisions of Section 276, and should not be read together so as to result in one contradicting the other, as the Commission's Order has done.

[8] Moreover, Computer III (unlike Computer II) did not involve any major reclassification of existing assets from regulated to nonregulated status. There were no assets transferred in Computer III. Unlike payphone equipment, which has been regulated for years and now is being transferred to nonregulated status, the enhanced services at issue in Computer III had not been provided at all by the LECs, and therefore did not involve any substantial amount of regulated assets that had to be converted to nonregulated status. Thus, there is no reason to believe that the references to Computer III were intended to change the expressed Congressional intent regarding valuation of existing payphone assets.

In summary, the unambiguous Congressional intent is for the Bell companies' payphone operations to be transferred, at an appropriate valuation, from regulated accounts to unregulated books. A clear statement of Congressional intent cannot be overridden unless it is in direct conflict with the plain meaning of statutory language. Here, it is clearly possible to read the statute as consistent with relevant indicia of intent, and the Commission therefore must do so.

C. Policy

In addition to being contrary to unambiguous Congressional intent, the Commission's decision on valuation is contrary to sound public policy and the Congressional command to eliminate all payphone subsidies.

1. Ratepayer Effects

As mentioned above, the Commission's Order recognizes that going concern valuation, including valuation of intangibles, is the appropriate method of ensuring that ratepayers are appropriately credited for affiliate transactions. That was the method recognized by the Commission in Computer II, where net book value was used as a surrogate for economic value only because, in the circumstances then present, the Commission concluded that (1) net book value was a reasonable proxy, (2) appraisal of economic value was impractical, and (3) ratepayers were protected by being given the option to buy their CPE at net book value. Here, none of these conditions are present. Thus, there is every reason to require a transfer at appraised economic value in order to ensure that ratepayers receive the full value of the sums they have invested in regulated payphone equipment that is now being deregulated at a substantial gain over net book value.

Even assuming that the Commission were free to disregard Congressional intent, there are no persuasive policy reasons why the transfer of payphone assets should be valued at net book value instead of actual economic value. The Commission states that its cost allocation rules are fully adequate to protect ratepayers from subsidizing LEC payphone operations. However, the Commission cannot point to any justification other than the alleged need for consistency with existing rules, that would explain why valuation of payphone assets at true economic value, which concededly is the appropriate and necessary result if the payphone operations are transferred to a nonregulated separate subsidiary, is not also the appropriate and necessary result when the payphone operations are transferred to a nonregulated payphone division.

This is not a situation where allocation of assets (such as network facilities) between regulated and nonregulated activities is likely to change over time, so that accounting convenience and business efficiency might be served by leaving the entire pool of assets in one set of accounts and allowing the carrier to periodically reallocate the assets without having to recreate an economic transaction each time. The assets in question are payphone equipment and enclosures[9] -- discrete items that are placed on customer premises and that are easy to identify and separate from other types of investment such as network facilities.[10] These assets

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[9] In addition, as discussed above, there are related intangible assets such as contracts for the location of such payphone equipment and enclosures, and related goodwill.

[10] The Commission recognized the severability of payphone operations from network (Footnote continued)

have been declared <u>100% permanently nonregulated</u>, as a matter of law. Barring some extraordinary reversal of policy, no portion of these assets is <u>ever</u> going to be "reallocated" back to the regulated side. Therefore, there is no reasonable basis for concluding that retaining these assets in regulated accounts, and depriving ratepayers of compensation for their true economic value that is likely to be far in excess of net book value,[11] will provide any significant protection for ratepayers.[12]

(Footnote continued)
facilities when it ruled that: "payphone assets to be reclassified or transferred [do not include] the loops connecting the payphones to the network, the central office "coin-service," or operator service facilities supporting incumbent LEC payphones. . . . " <u>Order</u>, ¶ 159.

11 Contrary to the Bell companies' claim, the gains resulting from a valuation at actual economic value at the time of the reclassification/transfer to nonregulated books could and should be recognized under the Commission's price cap rules as an exogenous cost adjustment "triggered by administrative, legislative or judicial action beyond the control of the carriers." Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786, 6807(1990). Such exogenous cost adjustments include, among other things, "[t]he reallocation of investment from regulated to nonregulated activities pursuant to § 64.901; [and] [s]uch tax law changes and other extraordinary exogenous cost changes as the Commission shall permit or require . . . ." 47 CFR § 61.45(d)(1)(v), (vi). From the perspective of the purposes of the exogenous cost rules, the transfer of LEC payphone operations from regulated accounts to nonregulated books is the same sort of exogenous change as the "reallocation of investment from regulated to nonregulated activities," and is clearly the type of "extraordinary exogenous cost change" that the Commission intends should be covered by the exogenous cost adjustment rule.

12 The Commission's belief that ratepayers are adequately protected by a net-book-value cost allocation is further undercut by the statement that "exepnses incurred during the period payphones were regulated remain as regulated expenses. . . ." <u>Order</u>, ¶ 159. The Commission's approach thus precludes protection of ratepayers even from the use of ratepayer money to pay substantial up-front bonuses by LECs to secure profitable locations just prior to deregulation -- an acknowledged industry practice and instances of which are documented in the comments filed by the Inmate Calling Services Providers Coalition.

Further, the Commission acknowledges that the increment of economic value over net book value should be credited to ratepayers if the payphone division were actually being sold out of regulation to an unaffiliated buyer (as at least one Bell company has been attempting to do) or even to a BOC affiliate. The Commission states that under its accounting rules, when deregulated assets remain on the regulated books, "any resulting gains from a sale of those nonregulated assets accrue to the carrier and to the benefit of ratepayers and shareholders." Order, ¶ 165.[13]

Assuming that this statement correctly describes the legal effect of a sale of assets that have already been reclassified as nonregulated, then the valuation mandated by the Order would still be against public policy because it would substantially remove any incentive of the Bell companies to sell their payphone operations, even at a profit. Since any profit would have to be credited back to ratepayers, the Bell companies would be incented to hold onto their payphone operations as long as possible.

The Commission's decision on the valuation of LEC payphones creates perverse incentives and does not serve the public interest. The Commission's decision that the economic value of the payphone assets will only be recognized if a LEC 'transfers' its payphone operations to a separate affiliate creates a significant disincentive for LECs to choose this

[13] However, the Commission does not explain which of its accounting rules would determine the treatment of such a sale, or how any ratepayer credits resulting from such a sale would actually be implemented to benefit ratepayers under the Commission's price cap rules. For all that appears, application of cost allocation rules to the deregulation of payphone assets will preclude the value of intangibles from ever being credited to ratepayers. No rule is cited that would prevent a Bell company from selling its payphone operations and sharing none of the intangible value with ratepayers.

option as the means by which they will operate their nonregulated payphone operations. Even if this were the preferred and most economic choice of a LEC, the Commission's decision effectively prohibits a LEC from choosing this option. Barring extreme circumstances, no rational LEC would elect to operate its nonregulated payphone operations through a separate affiliate if it knows a priori that by so doing, it will lose its ability to ensure that the value of intangibles will accrue to the benefit of stockholders instead of ratepayers. Thus, while the Commission concluded that "the BOCs or other incumbent LECs are free to provide these services using structurally separate affiliates if they choose to do so" (Order, ¶ 157), the Commission's decision effectively precludes such a choice.

But there is no overriding public policy reason to incent the LECs to opt for the provision of their payphone operations through nonstructural separation. While, in some cases, nonstructural separation might be argued to serve the public interest by spreading some of the common costs to a LEC's nonregulated operations, in the case of payphones, the share of common costs that would be allocated to the nonregulated payphone operations is likely to be very small for the reasons discussed above. These supposed savings would most likely be swamped by the gain that ratepayers would realize if the payphone operations were transferred at fair market value to the nonregulated books of the LEC.

The Commission states that it "believes regulated ratepayers are better served by the requirement that carriers account for payphone operations in regulated accounts than if [it] required them to account for payphone operations in 'nonregulated' accounts or 'unregulated books'." Order, ¶ 171. The Commission does not provide any support for such a finding. In fact, just the opposite is true. Regulated ratepayers would be better served if the gain associated with the true economic value of the payphone operations was transferred to ratepayers now -- not at some unknown, if ever, time in the future. Moreover, since the Commission's decision creates such perverse incentives that LECs may never sell their payphone operations or transfer them to an affiliate, ratepayers may never realize or be compensated for the enhanced value of the payphone operations which they supported and subsidized while regulated.

The Commission's conclusion that it could at some time in the future capture any gain if a LEC should sell its payphone operations is flawed not only for the reasons previously discussed but for an additional reason. To the extent that the value of the payphone operations has been enhanced after deregulation, due to the superior management of the LECs, this enhanced value should belong to stockholders, not ratepayers. However, if the Commission waits until some time in the future, i.e., when the assets are sold or transferred to an affiliate, it will be extremely difficult to determine what portion of the gain should belong to ratepayers and what portion should belong to stockholders. If the Commission were to assign all of the gain to ratepayers, then ratepayers would be rewarded for an investment which they did not make. Rather than engage in the guesswork that would be required at some time in the future, the Commission should settle this matter now. Ratepayers will receive their fair share of any gain today and in the future, stockholders will receive their fair share of any gain.

The Commission can remove these perverse incentives and at the same time reward ratepayers for subsidizing the payphone operations while they were regulated and reward

LEC's stockholders if they sell their payphone operations in the future. By requiring that the LEC payphone operations be either transferred to the LEC's nonregulated books at their fair market value, including the intangible assets and goodwill, the Commission can remove the perverse incentives discussed above. Under this arrangement, a LEC would be indifferent between either structural or nonstructural operation of its nonregulated payphone operations. The decision would be based on sound economic and business principles, as it should be, not on a regulatory decision that provides perverse incentives. Furthermore, regulated ratepayers would receive the benefits of any gains realized from these transfers today as they should be valued -- not at some unknown time in the future when assignment of any gain will be pure guesswork. After the assets have been properly valued and transferred, any appreciation in the value of the assets in the future should remain with the nonregulated operations, and any profits or gains from the sale of these assets should accrue to the benefit of stockholders.

2. Competitive Effects

In addition to the impact on ratepayers for regulated services, there can be little question that undervaluation of payphone assets would have a distorting effect on the payphone marketplace. If net book value is, for example, only 50% of economic value, then the LEC would begin nonregulated operation by effectively being given half of its payphone base "for free." It is not credible to find that such a large and unwarranted economic windfall would have no effect on the behavior of the dominant payphone competitors.[14]

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[14] It is clear that the RBOCs believe that the Commission's decision on valuation of their payphone assets will have an economic effect. If the RBOCs did not believe they would be affected, they would not have directed their attorneys to submit a 13-page single-spaced legal memorandum opposing "going concern" valuation.